All icing. No cake.

Analysis of Climate & TCFD reporting and assurance trends in the FTSE 100.

December 2022

01 Executive summary

02 Scope & detailed findings

03 Conclusion

04 Reference

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01 Executive summary

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01 Executive summary

This article is a follow up to our November 2021 article titled 'Measuring Climate Risks and Opportunities'[1]. For the purposes of this article, we reviewed climate related disclosures across the FTSE 100, either in annual reports, ESG reports, or standalone TCFD reports.

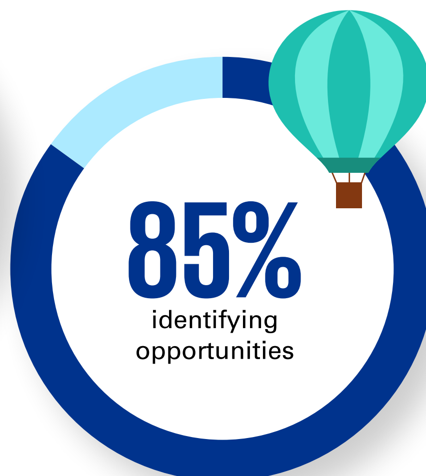
Through our research we identified three key findings that fall under one critical theme.

Whilst we are seeing progress in climate disclosures and reporting in the FTSE 100, we expect further improvements on the level of detail and quality of data that supports companies climate commitments and reporting of progress towards these.

In particular, we found the areas requiring the most work relate to the quantification of climate risks and opportunities, climate transition plans and the climate link to directors remuneration.

Quantification of climate risks and opportunities - 'All Icing, No Cake'

Both climate related risks and opportunities identified were clearly outlined across all the FTSE 100 companies we reviewed, with **95%** identifying risks and **85%** identifying opportunities[1]. It's good that reporters view climate in this balanced way. However, we identified that some companies are not yet in a position to quantify the extent to which these risks and opportunities will impact their business - quantification was only provided by **11%** of the FTSE 100. Those that did quantify provided more generic narrative which was limited in detail. We expect more companies to include quantification in the future, particularly given proposed disclosure requirements relating to climate transition plans.



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01 Executive summary (cont.)

Climate transition plans - Net Zero? No Problem?

Of the FTSE 100, **98%** have set a GHG target, for operational emissions (Scope 1 & 2). Of these, some companies have also included value chain (inclusive of Scope 3) Net Zero targets by 2030. Whilst there are some reporters who have set targets of 2040 or 2050, a large proportion of those we reviewed provided a 2030 target date. Companies will need credible climate transition plans to evidence how they will achieve these targets. The data behind those targets and supporting the progress against those targets needs to be of a high quality and stand up to the scrutiny of external assurance.

ESG. An easy pay-day?

Ensuring that there is Board level buy-in is critical to companies being able to integrate climate related risks and opportunities into their strategic planning both in the short and longer term. Bringing accountability through linking environmental and climate related metrics to directors' remuneration is increasingly common.

Of the FTSE 100, **53%** have climate or environmental metrics linked to directors' remuneration. Unfortunately, in many instances it wasn't clear exactly how these targets were being measured given they formed part of a balanced scorecard, nor was it clear how stretching these targets might be to achieve. Furthermore, it was unclear to what extent the non-financial targets being set are reviewed and assured.

The Importance of Assurance

Underpinning the robustness of the climate metrics and disclosures reported in relation to our key findings above, it is important for companies to understand the breadth and level of assurance that is being obtained (both internally and externally).

Currently about three-quarters of the FTSE 100 receive an assurance opinion over ESG metrics.

However, the majority of these opinions are limited assurance and while this is better than no assurance, there is a way to go before the higher bar of reasonable assurance is the norm, given **only 7% of ESG assurance opinions are being provided on reasonable assurance basis**.

Summary

Overall, the quality and consistency of ESG and climate related disclosures needs to continue to improve, underpinned by controls (similar to those applied to financial information) and robust data which is reliable and assurable. For more information, detailed findings are available within the attached appendices. Please also contact our experts.

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02 Scope & detailed findings

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02 Scope & detailed findings

Scope of Research

This article is a follow up to our November 2021 article titled 'Measuring Climate Risks and Opportunities'. This article aims to assess the disclosure of climate related financial information across the FTSE 100, either in annual reports, ESG reports, or standalone TCFD statements. Throughout this research, we refer to other publications including that of the FRC's reporting on TCFD progress and look to highlight commentary from stakeholders on the importance of data quality and assurance within TCFD and climate reporting.

This review of disclosures also included understanding the metrics used by companies, a review of directors' remuneration reports, as well as the review of the narrative and strategy set out by FTSE 100 constituents.

In line with our prior year research, we have focussed research on those identified as potentially most affected by climate change by the TCFD[2] and referred to those as 'highly exposed'. We have however not forgotten those who are not considered 'highly exposed', and those have also been reviewed throughout the research.

Furthermore, as our research has focused on the FTSE 100, it is to be expected that there is some churn in the constituents of the FTSE 100, to which effect we have seen at least 10 changes from our original research in October 2021 as at the time of our research (April – August 2022). We have based our results on the latest available reports during our research period (April – August 2022) and therefore some organisations with June/September year ends may not have been captured by TCFD requirements at this reporting stage.

We have additionally expanded our land use definitions to take into consideration any organisations that may also be following the preliminary recommendations of the Taskforce on Nature-related Financial Disclosures (TNFD)[3]. Whilst we do not expect that any organisations will be following the TNFD's recommendations at present, it is likely that some metrics and targets and even strategy may already integrate some of these recommendations within current reporting. For example – we have seen significant increase in land related performance indicators, which correlates with elements such as land related biodiversity targets and metrics that we have focused included within our definition.

The 100 companies reviewed have been categorised by industry sector to enable more specific analysis of disclosure and assurance gaps within specific sectors. This enables analysis of the disclosure of the metrics that are most relevant to a sector, such as land and water use within the agricultural sector. Within this categorisation there are 8 identified industries that have higher exposure to climate related risks. However, following the TCFD Status Report for 2021[4] we have categorised the Technology and Media, and Consumer Goods industries to reflect the AI review performed within the status report, to allow a comparison alike the TCFD status report.

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02 Scope & detailed findings (cont.)

Detailed Findings

Risks and Opportunities

Are Companies disclosing opportunities identified from the transition to a lower-carbon economy?

Climate risks and opportunities are highly important for businesses. The TCFD states:

> **"Financial markets need clear, comprehensive, high-quality information on the impacts of climate change. This includes the risks and opportunities[5]."**

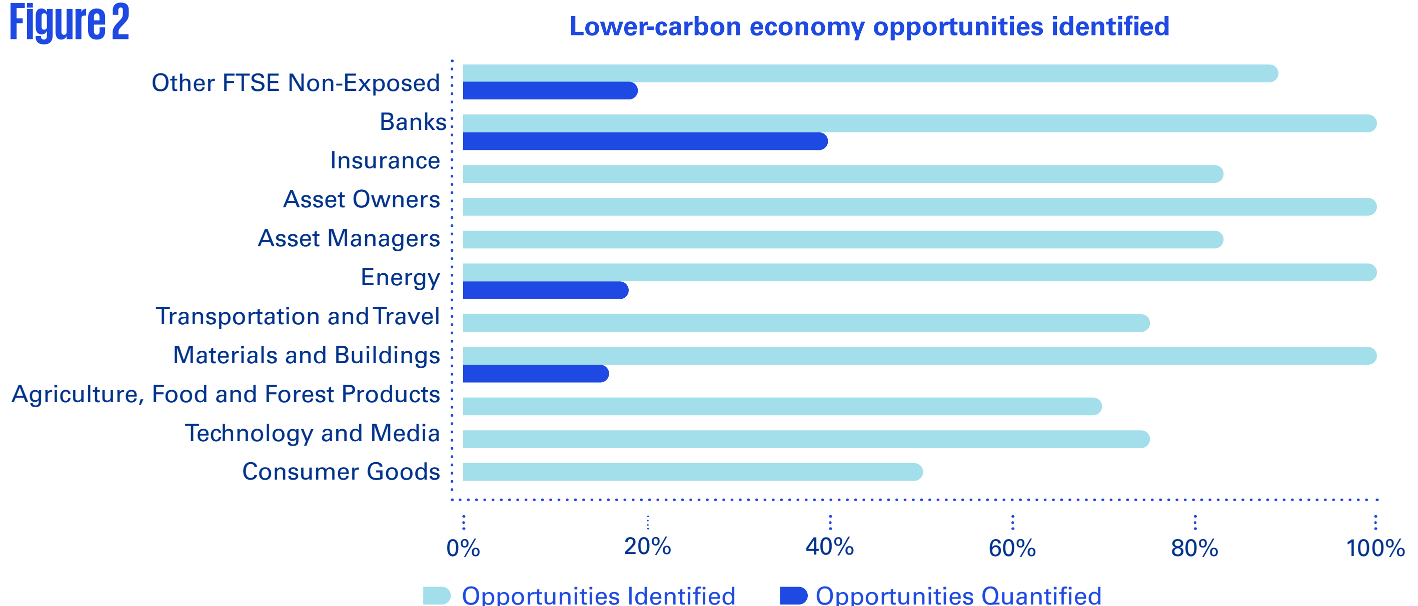
Measuring risks and opportunities is critical for organisations to both understand for themselves and disclose to stakeholders how their operating model may need to adapt to changing climate scenarios., Without this, confidence could be lost in the ability for a company to thrive in a lower-carbon economy.

Within this year's review, **85%** of the companies provided an analysis of opportunities resulting from transitioning to a low-carbon economy. However, only **13%** of the companies that identified opportunities went further to quantify the possible benefit through metrics or financial measures.

Overall, the number of companies identifying lower-carbon economy opportunities has increased from **64%** of entities analysed in the previous period. This suggests that although companies are identifying increased opportunities arising from the transition to a low-carbon economy and are keen to share these opportunities with stakeholders, there is not yet a consistent approach to disclosing opportunities..

In particular, the Consumer Goods sector was found to be the lowest performer with only **50%** disclosing the opportunities identified as a result of transitioning to a lower carbon economy, whilst both energy and asset owning companies lead the way in identifying opportunities, perhaps due to the fact that adapting consumer products to that of a lower carbon economy may be a more difficult venture than that of energy companies identifying opportunities by looking to provide lower-carbon energy product offerings. Unfortunately, the narrative surrounding the opportunities disclosed was generic with limited information provided as to how the opportunity would be realised and could benefit stakeholders.

An analysis by sector of entities identifying opportunities from the transition to a lower-carbon economy



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02 Scope & detailed findings (cont.)

Are Companies disclosing climate related risks from a transition to a lower-carbon economy?

KPMG's review found that **95%** of companies identified climate related risks within their disclosures and reporting. However, of the companies that identified climate related risks, only **6%** quantified these risks, whereas the vast majority simply discussed the risks in qualitative terms. Interestingly, as figures 2 and 3 demonstrate, the same industries are quantifying risks as opportunities. However, risks are less likely to be quantified by almost half. Perhaps this indicates that companies may believe that quantified potential risks may deter stakeholders and undermine confidence in the organisation, however it should be noted that due to quantification not yet being mandatory, there may not yet be motive to get lead the pack.

But generic information does not assist investors or management in making informed decisions, especially when these risks imply that climate risks may have a material impact on operations, but the narrative adds limited detail to these implications.

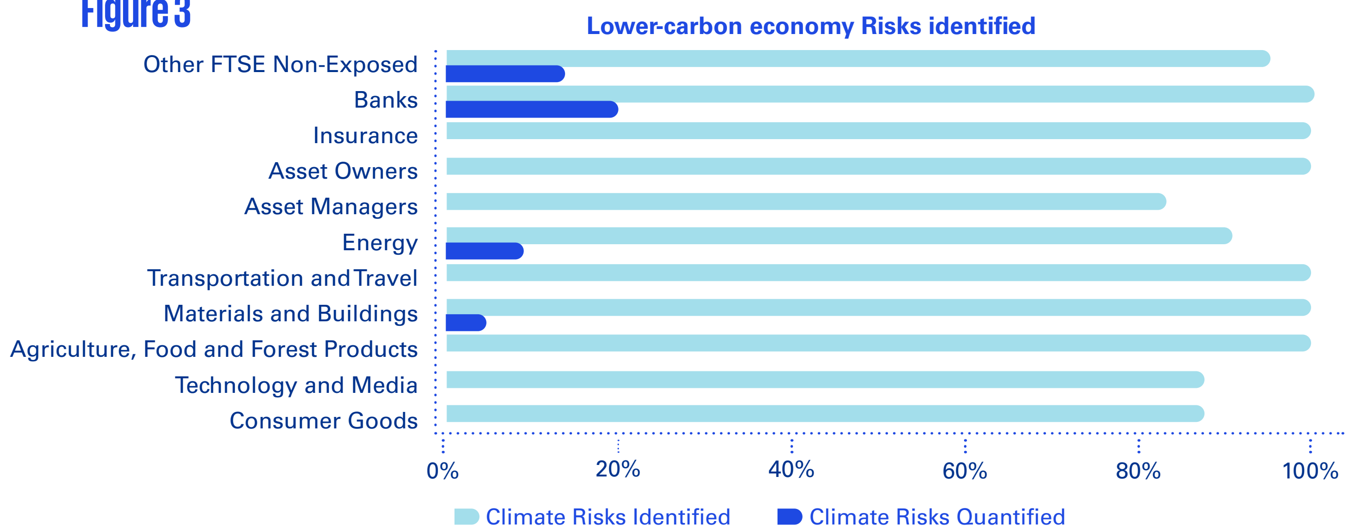
Overall, it was found that of the 100 companies reviewed, most sectors were more likely to identify risks than opportunities arising from the transition to a lower-carbon economy. This may be reflective of overall sentiment within the FTSE 100 or a more cautious approach to identifying potential opportunities that may arise.

Quantification and Data Quality of Opportunities and Risks

For both opportunities and risks identified resulting from a transition to a low-carbon economy, quantification was limited, with generic narrative surrounding. We would expect that more companies may start to include quantification in the future, particularly given proposed disclosure requirements relating to climate transition plans[6]. The current degree of quantification isn't surprising when considering the number of estimates and assumptions that must be factored into the thought process of considering both opportunities and risks. The process of quantifying requires high quality data, and no quantification can be relied on in the absence of dependable data.

Quantifying risks and opportunities can benefit both investors and companies by assisting with decision making, helping to identify and deep dive into where climate related risks impact their business, and avoiding potentially costly climate interruptions and damages[7].

An analysis by sector of entities identifying risks from the transition to a lower-carbon economy.



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02 Scope & detailed findings (cont.)

Disclosure of Scope 1, 2 & 3 emissions:

Of the FTSE 100, **98%** have set a GHG target, for operational emissions (Scope 1 & 2). Of these, some companies have also included value chain (inclusive of Scope 3) Net Zero targets by 2030. Whilst there are some reporters who have set targets of 2040 or 2050, a large proportion of those we reviewed provided a 2030 target date. Companies will need credible climate transition plans to evidence how they will achieve these targets.

KPMG's analysis found that within the FTSE 100, Scopes 1 and 2 were disclosed by 99% of entities, with **83%** reporting at least one category of Scope 3.

KPMG's review in the prior period found that Scope 1 & 2 emissions were disclosed by **97%** of companies reviewed, alongside **88%** reporting some categories (mainly employee commuting and travel) of Scope 3, which unfortunately is not a material increase. It is possible that Scope 3 data is being collated by the remaining **12%** of organisations yet to report.

However, as part of this year's review it was found that many of these reported Scope 3 disclosures do not yet provide comprehensive accounts of the upstream and downstream emissions generated as a result of the wider value chain of a company. With a limited number of Scope 3 categories disclosed, many companies chose to focus on easier to determine metrics such as Category 6: Business Travel.

The United Nations Global Compact states that as Scope 3 emissions usually account for more than 70 percent of a business' carbon footprint, it is therefore crucial that companies tackle Scope 3 emissions to help meet the aims of the Paris Agreement and limit global warming to 1.5°C[8].

The science-based targets initiative deems Scope 3 emissions to be significant if they equate to **40%** or more of the company's overall emissions[9]. On this basis, it is concerning to see that of the 100 companies analysed, only around **54%** had received assurance over any form of Scope 3 emissions.

In many cases the extent of reporting only covers business travel and/or employee commuting, with Scope 3 emissions in some instances responsible for up to 90% of a company's carbon emissions[10] when accounting for the entirety of the value chain. Given the importance of Scope 3 emissions, it is evident that Scope 3 disclosures are limited and that current disclosures are not reflective of the overall business operations of many companies. Very few companies explicitly stated the emissions per category of Scope 3, rather either disclosing immaterial categories such as business travel, or disclosing Scope 3 as a whole figure. This makes it difficult to identify where improvements are being made throughout the value chain and suggests that the current levels of disclosures are not reflective of the full upstream and downstream emissions impacts from operations.

Investment research firm MSCI summarises that the state of scope 3 reporting is poor and that regulators are increasingly focusing on Scope 3 emissions. MSCI also note that 'For some companies and industries, Scope 3 emissions dominate the overall carbon footprint. For example, the Scope 3 emissions of the integrated oil and gas industry (measured by the constituents of the MSCI ACWI Index) are more than six times the level of its Scope 1 and 2 emissions[11]'. This again highlights the need for improvements within scope 3 reporting in order to provide a true picture of an entity's operations, or the performance of investment portfolios invested in sectors associated with high scope 3 emissions such as the energy industry.

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02 Scope & detailed findings (cont.)

GHG Assurance

Assurance over GHG emissions Scopes 1 & 2 are the most common metrics. Where an assurance opinion is provided to a FTSE 100 organisation, Scope 1 is assured in **93%** of cases and Scope 2 in **92%** of opinions. **With 75% of the FTSE 100s receiving an ESG assurance opinion at present**, it is clear that assurance over climate and GHG emissions is highly sought after.

Furthermore, KPMG's review found that the most frequent Scope 3 categories that were disclosed and had assurance work performed over were category 6 (Business Travel) and category 7 (Employee Commuting). Which, for many organisations are the easiest to calculate, but also likely to be the least material.

Scopes 1-3 are the foundational elements of achieving net-zero targets. Companies must take these metrics seriously in order to achieve lower carbon targets. Assurance can help stakeholders understand whether this data is reliable and in line with recognised standards such as the GHG protocol.

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02 Scope & detailed findings (cont.)

Materiality Assessments and Relevance:

Materiality assessments are critical for organisations to understand and dissect what is important to stakeholders and will help to understand where the greatest effects can be made in relation to climate impact reductions. For an office-based company, land use metrics may not be as useful to focus time and resources to gather data and make reductions when it is a relatively immaterial element to the organisation.

If companies have not performed a materiality assessment previously, they should start with standardised tools which can be used to help identify potentially material topic areas. The SASB[12] materiality finder can assist by helping to identify relevant issues which can help inform disclosure, whilst the GRI 101[13] helps inform users how to conduct a materiality assessment and what topics should be prioritised. Table three helps to highlight which targets FTSE 100 companies deem worth setting and disclosing targets against. Clearly, as expected, energy targets are at the front - with many organisations committing to net-zero, whilst land use is less common and generally tends towards disclosure of deforestation targets.

What should be noted in reference to materiality assessments, is that the disclosure of metrics and setting of targets does not necessarily reflect the risks of what will impact business operations for a company. For example, it is likely that insurance companies will be heavily impacted by rising water levels, which result in a greater number of claims against home insurance. Measuring water use and setting targets against water, which only **16%** of insurance companies currently do, will not necessarily help to mitigate these risks.

Companies must take a holistic approach to understanding how their risks can be addressed and what metrics should be measured to assist in responding to them. Any assumptions and estimates used for the basis of these risk assessments should be subjected to independent assurance to reduce the possibility that risks are not being appropriately addressed.

Organisations should also consider whether obtaining assurance over their materiality assessment could provide benefit, ensuring that all perspectives and processes were followed when identifying material topics. This is critical in helping to ensure that appropriate risks and material areas are identified.

Summary of Disclosures of Targets within the 100 Companies Reviewed:

	Energy targets	Water targets	Land use targets	Waste targets
Other FTSE Non-Exposed	95.2%	71.4%	38.1%	81.0%
Banks	100.0%	80.0%	40.0%	100.0%
Insurance	83.3%	16.7%	33.0%	33.3%
Asset Owners	100.0%	50.0%	50.0%	0.0%
Asset Managers	83.3%	16.7%	33.3%	50.0%
Energy	90.9%	63.6%	63.6%	63.6%
Transportation and Travel	100.0%	75.0%	50.0%	100.0%
Materials and Buildings	94.7%	68.4%	73.7%	78.9%
Agriculture, Food and Forest Products	90.0%	80.0%	80.0%	80.0%
Technology and Media	87.5%	25.0%	0.0%	75.0%
Consumer Goods	87.5%	87.5%	75.0%	100.0%
Total %	**92.0%**	**61.0%**	**52.0%**	**75.0%**

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02 Scope & detailed findings (cont.)

Directors' remuneration linked to ESG metrics:

After conducting materiality assessments, companies have identified the metrics significant to their operations, and the importance of achieving senior buy-in and quality of data. The TCFD recommends that remuneration is disclosed as part of the wider governance of climate disclosures.

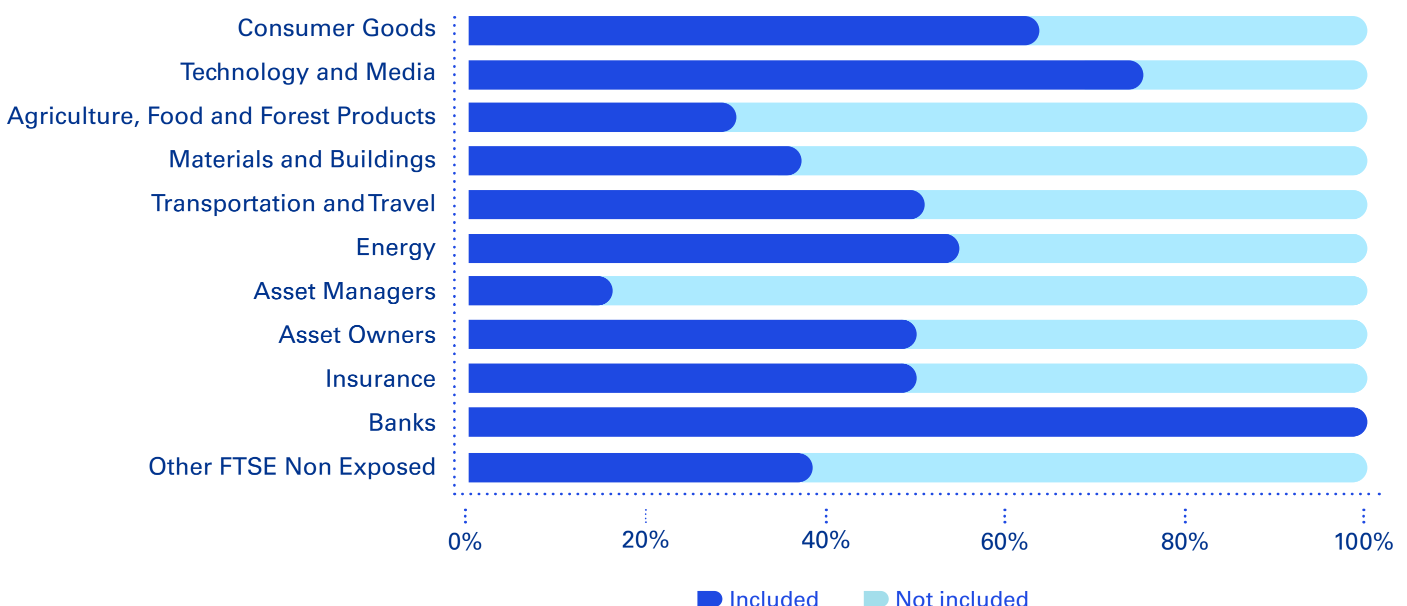
Linking climate and remuneration can help increase prioritisation of and management support. As part of our review, **it was noted that 75% of reviewed entities had directors' remuneration linked to some form of ESG metric, with 53% of the FTSE 100 linking to a climate or environmental target.** This compares favourably to only **69%** of entities linking remuneration to ESG in the previous period analysed by KPMG. It is positive to observe that there is increasing senior commitment to ESG disclosures in the majority of analysed companies.

There are of course laggards, in particular Asset Managers and Agriculture, Food and Forest Product sector entities were noted to be underperforming in comparison to the overall FTSE 100 in linking directors' remuneration to climate or environmental metrics, with only **16%** and **30%** of these companies linking ESG performance to remuneration. Which for Agriculture, Food and Forest Product companies is particularly surprising given the inherently high environmental impact of this industry. Similarly, the Material and Buildings sector only linked environmental or climate metrics to remuneration in **37%** of instances

For those with higher exposure to environmental damage and climate change, incentivising progress to help mitigate and reduce impacts is critical, and consideration should be made as to whether remuneration should be linked to climate, the environment and broader ESG topic areas.

An analysis of entities that disclose the inclusion of Environmental or Climate performance metrics within executive remuneration.

Figure 7



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02 Scope & detailed findings (cont.)

BlackRock Investment Stewardship has noted that it is helpful when companies integrating sustainability-related criteria in their incentive plans clearly explain the connection between what is being measured and rewarded and the company's strategic priorities. BlackRock states that not doing so may leave companies vulnerable to reputational risks and/or undermine their sustainability efforts[14]. Therefore, the robustness and reliability of data is critical in ensuring that appropriate remuneration is achieved.

In addition, the same BlackRock report emphasises the need to use appropriate, rigorous, and stretching goals tied to relevant strategic metrics. It is noted that the vesting schedules and holding periods associated with incentive plans should facilitate a focus on long-term value creation. The use of shorter term ESG metric-based incentives, vesting at a single point, can conflict with the long-term nature of an entity's ESG goals. As a further incentive to utilise ESG metrics within remuneration, a Harvard study[15] found that

> **positive ESG results can drive long-term shareholder value; it seems likely that executive incentive plan designs will increasingly include "quantifiable" ESG measures.**

The Principles for Responsible Investment (PRI) highlights however, that vague ESG factors can add to the complexity of remuneration structures and that excessive focus on certain ESG metrics could hinder sustainability objectives (e.g., linking metrics such as time lost to injury to pay could discourage accurate reporting and risk monitoring)[16]. It is then further linked that ESG targets that are too easily achievable and insufficiently rigorous may unnecessarily boost pay for executives, particularly during economic downturns where purely financial metrics would be unlikely to be achieved. This again emphasises the importance of remuneration committees to utilise long-term, sufficiently rigorous, and understandable ESG metrics within directors' incentive plans.

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02 Scope & detailed findings (cont.)

Data Quality in Scenario Analysis:

A key component of TCFD reporting is the scenario analysis whereby companies assess their risks and opportunities against differing global temperature rises. To assist with this, companies should assess their operations in a lower carbon economy whilst reflecting on factors such as carbon pricing, risks and opportunities whilst considering estimates and assumptions.

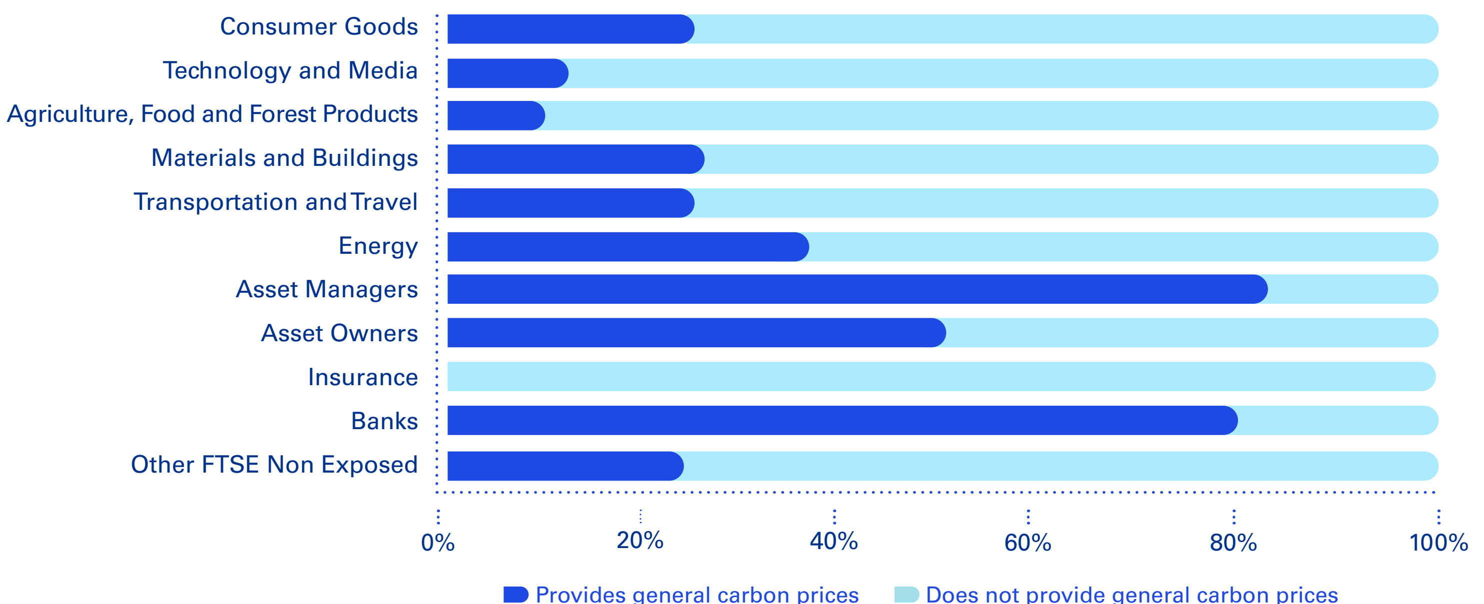
KPMG's analysis found that reviewed companies are inconsistent in their approach to scenario analysis, with varying levels of data quality. Some organisations looked to implement an estimated carbon price into their scenario analysis which due to the fluctuations, is difficult to predict and integrate. Some studies indicate that the price per metric tonne of carbon can vary widely by region and industry[17].

Per figure 8 it is evident that Asset Managers and Banks most frequently disclose their estimated carbon prices as part of scenario analysis within TCFD reports.

Perhaps given the leader nature of financial service organisations, due to their greater information advantage, there is a greater confidence in the future pricing of carbon into their scenario analysis, whilst organisations in the Agriculture, Food and Forest products sectors have less access to advanced modelling tools and information, and hence they fall behind in carbon pricing integration within scenario analysis.

It should be noted that the incorporation of carbon pricing is no easy feat, there are many assumptions and estimates that go into predicting climate scenarios. The price of carbon is another one of those factors, with fluctuating prices, creating a reliable estimate is difficult. In our previous publication, in August 2021, EU Carbon credits as part of the EU Emissions Trading System (ETS) were around €60 per tonne, now a year later in August 2022 per tonne price is €92 and reached as high as €98 in mid-August[18]. It is for this reason that companies must ensure that all other data, estimates, and assumptions are accurate, verified, and reliable before applying carbon pricing principles to scenario analysis.

An analysis of whether reviewed entities provide general carbon prices.



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02 Scope & detailed findings (cont.)

Introduction to Assurance

Obtaining assurance isn't just a simple case of requesting assurance and receiving an opinion. Assurance is a useful tool to help improve management understanding of data quality and processes. Reviewing and testing of data by an independent third-party can help to unearth deficiencies or areas for improvement that may not have been known to the organisation previously.

There are differing types of assurance, and these vary depending on the needs of your business. Assurance engagements in the UK follow ISAE (UK) 3000[19] and result in an internationally recognised opinion.

Reasonable assurance is seen as a milestone along the journey of reporting, for now, most companies are at the starting point in their journey to implement and improve data quality to achieve the desired unqualified reasonable assurance opinion. Data is developing and changing too fast, and sustainability specialists whilst experts in their ESG space, have not been as exposed to the control environments expected of finance teams. Assurance is therefore a key tool as limited assurance can help to probe these control weaknesses, without impacting an opinion. Limited assurance tends to focus on the quantitative aspects over certain selected KPIs and Metrics, with companies electing to expand their scopes as they gain comfort over data as they progress through assurance cycles.

Assurance Type	Procedures	Outcome
Limited Assurance(93% of FTSE 100 opinions are limited assurance)	Substantive Analytics Risk based evidence testing Walkthrough and process understanding	Negative framing of opinion - 'Nothing has come to our attention'
Reasonable Assurance	All above procedures Controls testing Akin to a financial audit	Positive framing of opinion – 'In our opinion the report presents fairly, in all material respects'

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03 Conclusion

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03 Conclusion

Our research has found that reporting on climate disclosures is evidently varied, with some organisations showing buy-in whilst others being more reactive in their reporting, following market trends as opposed to leading the pack.

The climate risks and opportunities disclosed by companies has demonstrated limited quantification, leaving stakeholders uncertain of the impacts future climate changes will have on companies. Directors' remuneration shows promise with climate and ESG being linked in **75%** of FTSE 100 organisations, however targets are being set against metrics that are not necessarily being assured or at least not to the same extent that financial targets would be reviewed.

Underpinning these targets is data that may subject to changing methodologies and incremental improvements - do you trust that data to be as accurate and supported by rigid processes and controls as that of financial information? If not, why is this?

At present less than 10% of FTSE 100 companies are receiving any form of reasonable assurance over non-financial metrics. This means that for at least 90% of organisations receiving an assurance opinion over non-financial information, this testing is limited in scope, and whilst assurance can help to bridge the gap in data quality between financial and non-financial information, the question must be asked: Are you doing enough?

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